LIBRARY
SUPREME COURT, U. S.

Office - Supreme Court, U. S.
DEC 10
CHARLES ...

IN THE

# Supreme Court of the United States

**OCTOBER TERM, 1948.**

**No. 168.**

---

THE CITY OF NEW YORK,

*Petitioner,*

vs.

LEWIS H. SAPER, as Trustee in Bankruptcy of SPOTLIGHT PRODUCTIONS, INC.,

*Respondent.*

---

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

---

## BRIEF FOR RESPONDENT.

---

DAVID HAAR,
*Attorney for Respondent.*

# INDEX.


PAGE

The Argument ..... 2

POINT I—Petitioner's contention that there is an "established rule" that interest runs on taxes to the date of payment is erroneous ..... 2

POINT II—The cases which allowed interest to run on taxes up to the date of payment, overlooked the nature of a tax, as distinguished from interest because of non-payment of the tax ..... 5

(A) A tax is a debt under the Bankruptcy Act.. 5

(B) Interest is not a tax ..... 8

POINT III—Section 57j of the Bankruptcy Act has been misconstrued as applying to interest on taxes ..... 9

POINT IV—From the point of view of orderly bankruptcy administration, and of fairness to other creditors, the practice of paying interest on tax claims up to the date of payment should be discontinued ..... 11

Conclusion ..... 13


TABLE OF CASES CITED:


*Capital Building & Loan Assn.* v. *Commissioner*, 23 B. T. A. 848 ..... 8

*Dorsey, Matter of* (1941), 46 A. B. R. (N. S.) 146....3, 11

*D. O. Summers Co., In re*, 45 A. B. R. (N. S.) 123..3, 11

*Fischer & Co., In re*, 148 Fed. 907 (D. C. N. J., 1906).. 2, 3

*J. Menist & Co., In re*, 290 F. 947 (C. C. A. 2, 1923).. 7, 9

*Kallak, In re*, 147 Fed. 276 (D. C. N. Dakota, 1906)..2, 3, 13

*Kaw Boiler Works* v. *Schull*, 230 F. 587 ..... 7

PAGE

*Pearisse v. United States*, 18 F. Supp. 413 ..... 8

*Sexton v. Dreyfuss*, 219 U. S. 339 ..... 9

*Sherwood; In re*, 210 F. 754 ..... 7

*Union Fabrics, In re*, 73 Fed. Supp. 685 (D. C. S. D. N. Y.) ..... 11

*United States v. Childs*, 266 U. S. 304 (1924) ..... 10

*United States v. Both*, 164 F. (2) 575 ..... 7

*Vanston Bondholders Protective Committee v. Green*, 329 U. S. 156 ..... 9

OTHER AUTHORITIES CITED:

Bankruptcy Act:

Section 57j (11 U. S. C. A., Sec. 93j) ..... 9, 10, 13

Section 64 (14 U. S. C. A., Sec. 104) ..... 5

IN THE

# Supreme Court of the United States

**OCTOBER TERM, 1948.**

**No. 168.**

---

THE CITY OF NEW YORK,

*Petitioner,*

vs.

LEWIS H. SAPER, as Trustee in Bankruptcy of SPOTLIGHT PRODUCTIONS, INC.,

*Respondent.*

---

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

---

## BRIEF FOR RESPONDENT.

The statement of facts presented by the petitioner is substantially correct. And, as indicated in its brief, this appeal concerns itself with but one question, namely, was the order of the Circuit Court of Appeals for the Second Circuit correct in reversing the order of the District Court, by eliminating the petitioner's claim of interest on its tax claim up to the date of payment? To state the problem more broadly, is a tax claim entitled to payment of interest beyond the date when the petition in bankruptcy was filed?

## The Argument.

### POINT I.

**Petitioner's contention that there is an "established rule" that interest runs on taxes to the date of payment, is erroneous.**

Throughout its argument the petitioner seems to advance the contention that there is an "established rule" requiring the payment of interest on tax claims up to the date of payment.

We fail to find anywhere in the petitioner's brief, any reference to the "rule". If there is such a "rule" it should be found either in the Bankruptcy Act, or in the General Orders of this Court covering bankruptcy administration or, perhaps, in one of the rules of the District Court for the Southern District of New York. There is no such rule. Quite the contrary. The question of the payment of interest on taxes up to the date of payment has created considerable controversy.

In the same year that the case of *In re Kallak*, 147 Fed. 276 (D. C. N. Dakota, 1906), upon which petitioner relies so much, was decided, there was a case in New Jersey that decided just the opposite. We refer to the case of *In re Fischer & Co.* (148 Fed. 907) (D. C. N. J., 1906). There, too, the question arose as to whether the trustee was required to pay taxes plus interest to the date of payment. The Court said:

> "They (the Trustees) must therefore pay the taxes. It should be noted, however, that section 64 of the Bankruptcy Act does not provide for the

payment of interest on taxes, and the order will therefore be simply that the trustees pay the amount of the taxes without interest."

If there ever was such a rule as the petitioner urges upon this Court, it was challenged by the Referee in the case of *Matter of Dorsey* (1941), 46 A. B. R. (N. S.) 146. The Referee indicated in his opinion that he felt a sense of injustice to permit the payment of interest on taxes up to the date of payment. He said:

> "The position of the claimant is that during the period when there was no money to pay the claim the general creditors must not only pay the expense of getting together sufficient money to pay it in full, but also out of the 10% to 15% allowed to them they must pay interest to the state. This may be the law, but a mere statement of the facts awakens a keen sense of injustice."

Referee Frebolin, in the case of *In re D. O. Summers Co.*, 45 A. B. R. (N. S.) 123, felt himself bound to follow the precedent of the *Kallak* and similar cases. But he added that he had great doubts as to the soundness of the practice of paying interest on taxes up to the date of payment. He followed the precedent, saying, however, that he would do so "until some decision is rendered directly upon this point by the Supreme Court, or a Court whose decision is binding upon me."

What the petitioner calls an "established rule" is more in the nature of a practice, and even that cannot be considered as a precedent upon which to base an argument of a universal rule. Anyone familiar with bankruptcy administration knows that in a great many cases where tax claims are filed by the federal

government, the state government and the municipality, those tax claims consume the bulk of the estate, even without the addition of interest. In other words, since tax claims follow the payment of administration costs, and wage earners who also have priority, there comes a point where the balance left in the trustee's hands is not sufficient to pay even the amount of the tax claims, let alone the payment of any interest. In those cases the question of interest does not arise at all, with the result that rarely has there been any occasion to challenge the demand for interest on the part of the tax collector up to the date of payment. In those few cases where there was enough money to pay administration expenses, priority claims and tax claims, there has been some challenge made to the inclusion of interest. That challenge resulted in the opinions which we have indicated above, some for, and some against, the practice.

But to say that there is a "rule" which makes mandatory the payment of interest on taxes to the date of payment is to start with a wrong premise. There is no such "rule". The divergence of opinion among referees in bankruptcy, and among the higher courts, shows the absence of a "rule". The very fact that this Court has granted the petition for certiorari (to which we consented) emphasizes the diversity of opinion on the subject, and hence the absence of a "rule".

It is because of the absence of such a rule of guidance that this case has been taken to this Court, with the issue clearly presented on the single question in dispute, with the expectation that there will be a decisive opinion on the subject which will serve as a guide in the administration of bankruptcy cases.

In our argument we expect to show that, under the Bankruptcy Act, a tax is a debt—nothing more nor less—and that, as such, it stands on the same footing as debts due to other creditors, with the exception that the Bankruptcy Act requires payment in full of the tax that is due the government.

But the Act does not require payment of more than "in full" of the tax. Payment of the tax itself as a priority is authorized by law. We shall also show that payment of interest is not payment of a tax, and forms no part of it. Hence, payment of the interest beyond the date of petition filed is payment of more than "in full", because interest is not a tax.

## POINT II.

**The cases which allowed interest to run on taxes up to the date of payment, overlooked the nature of a tax, as distinguished from interest because of non-payment of the tax.**

### (A) A tax is a debt under the Bankruptcy Act.

Petitioner's counsel urges that the Chandler Act amending Section 64, did not convert a tax into a "debt" standing on a par with the debts due to other creditors.

We suppose that that argument is advanced because of the comment in the opinion of the Circuit Court on the amendment to Section 64 of the Bankruptcy Act in 1938 which it would seem, changed the former status of a tax claim to that of a "debt". But a careful reading of the opinion indicates clearly that the full recognition of a tax claim as a "debt" was also due to other factors, brought about by other changes

in the Bankruptcy Act. The Court stressed the history of the various amendments to the Act, and the revised practice brought about by these amendments, with respect to the method of proving tax claims in a bankruptcy case. The Court said:

> "At any rate, the process of assimilation of tax claims to other debts appears, to us at least, to have been completed by the Chandler amendments of 1938. Indeed we thus described the changes in *United States* v. *Roth*, *supra*, 164 F. 2d at pages 577, 578: 'By the 1938 amendments, however, taxes were classified as "debts" within section 64, sub. a, 11 U. S. C. A. Sec. 104, sub. a, and Section 57, sub. n, 11 U. S. C. A. Sec. 93, sub. n, was broadened to include "all claims of the United States" and require them to "be proved and filed in the manner provided in this section." Subdivision a of section 57, 11 U. S. C. A. Sec. 93, sub. a, provides that a proof of claim shall state among other matters "that the claim is justly owing from the bankrupt to the creditor"; * * * Thus it is apparent that the Act, as it now stands, treats the tax claim as a debt and the United States as a creditor which, like other creditors, must make proof of claim on a form prescribed by the Supreme Court. This, then, took from tax claims their former favored position where no proof or other governmental action was necessary for their enforcement. Thenceforth they must be proved, or otherwise be barred, just like other debts of the bankrupt."

The Court speaks of the "process of assimilation". The nature of a tax as a "debt" had long been foreshadowed in some of the cases. Indeed, in the very

case cited by the petitioner, to-wit, *In re J. Menist & Co.*, 290 F. 947 (C. C. A. (2) 1923), the Court refers to a tax claim as a species of a debt, and then cites *In re Sherwood* (210 F. 754) and *King Boiler Works* v. *Schall* (230 F. 587), as authorities which unquestionably consider taxes as debts owing to the government.

The "process of assimilation" was brought about by the requirement that taxing authorities must file proofs of claim as other creditors do. This requirement was not in existence prior to the amendment of 1938. As stated by the Court below, the proofs of claim to be used by the taxing authorities are exactly the same as the forms prescribed for unsecured creditors. Those proofs of claim must state the same facts as have to be stated by an unsecured creditor, and, under the decision in *U. S.* v. *Roth* (164 F. (2) 575), tax claims are no longer immune against set-offs on the part of the trustee, just the same as unsecured creditors are subject to the right of set-off.

Viewed by and large, the claim of a governmental authority for the payment of a tax due to it from the taxpayer, is nothing more nor less than a debt, because the amount of money set forth in the claim is owing from the taxpayer to the government. The taxpayer is a debtor; the government is a creditor; and that which is owing is unquestionably a debt subject to the same rights and obligations that any other debt of an unsecured creditor is subject to.

The only distinction given to the tax claim is that it is entitled to priority of payment. That distinction is given also to a wage-earner. But the wage-earner gets no interest after the date of the filing of the petition. If his debt gets priority, but no interest, why should a debt due to a governmental authority receive interest merely because it has priority of payment of the debt?

## (B) Interest is not a tax.

It needs scarcely any citation of authorities to convince this Court that interest is compensation for the use of money owing to a creditor, or its payment is required because of delay in payment of the debt due to a creditor.

Interest is usually exacted either by express contract, or by implication of law, or by statute. In the case of taxes, payment of interest is required by statute. But even that does not convert interest into a tax. We quote:

> "Interest on a tax is not a tax, but is something in addition to a tax. The additions to the tax, or additional amounts added to the tax, are not the tax which is referred to in the statute which we can find has been overpaid."
>
> *Capital Building & Loan Assn. v. Commissioner*, 23 B. T. A. 848.

In that case the question before the Board of Tax Appeals involved its jurisdiction to order a refund of interest paid on a tax. The Court held it had no jurisdiction to require a refund of overpayment of interest because, as stated, interest is not a tax. It is something in addition to the tax.

This case was cited with approval and followed in *Penrose v. U. S.* (18 F. Supp. 413, at 415) where again the question arose as to whether interest is a tax permitting its deduction in an estate proceeding. The Court ruled that interest is not a tax.

If interest is not a tax, then it is not entitled to priority of payment as a tax claim is. That too is another reason for our contention that where the Bankruptcy Act provides for the priority payment of a tax, that provision does not include the payment of interest after the date of bankruptcy, when all interest stops. *Sexton* v. *Dreyfuss* (219 U. S. 339, at 344); *Vanston Bondholders Protective Committee* v. *Green* (329 U. S. 156) (cited at page 18 in petitioner's brief as "*Vanston Commission* v. *Green* 329 U. S. 156").

## POINT III.

**Section 57j of the Bankruptcy Act has been misconstrued as applying to interest on taxes.**

Counsel for petitioner lays much stress in support of its contention upon the case of *In re J. Menist & Co.* (290 F. 947 (C. C. A. 2, 1923)) in connection with its argument that interest on a tax is payable up to the time of payment. A portion of the opinion is given at page 7 of its brief.

A reading of that portion of the opinion clearly indicates that the Court fell into error in holding that Section 57j of the Bankruptcy Act is applicable to the question of interest on the tax. The opinion refers to Section 57j as the basis for the conclusion.

But Section 57j clearly refers to penalties and forfeitures. It provides for the elimination of such penalties and forfeitures in a bankruptcy case, except that they may be allowed to the extent of the actual pecuniary loss suffered by the penalizing governmental authority.

But a tax, as we have seen, is not a penalty. It is a *debt*. No citizen who pays a tax considers himself penalized by reason of his contribution towards the

expense of running the government. The interest which he pays for delay in payment of the principal debt due to the government surely is not a penalty, no more than it is a penalty when he agrees to pay interest on a loan, or when the courts require the payment of interest for delay in paying a note, or other obligation.

We respectfully suggest that that case loses its force as an authority for the contention of the petitioner, since that case proceeded on the erroneous assumption that interest on a tax is payable under Section 57j of the Bankruptcy Act. Interest is not a penalty, and hence Section 57j cannot apply.

Nor did this Court approve the practice, nor base its decision on that of the lower Court, as the petitioner seems to claim by citing *U. S. v. Childs* (266 U. S. 304). This Court, in that decision, neither approved, nor disapproved the collection of interest on taxes as a priority up to the date of payment. It said nothing about it. All this Court did was to reverse the decision of the lower Court which had fixed the interest at 6% when the government had yielded on the 5% penalty by eliminating it from its claim, but insisted on the 1% interest. All that this Court held was that the Court below was in error in disallowing interest at 1% per month. It did not pass on the question as to whether that 1% per month was payable up to the date of bankruptcy, or up to the date of payment.

It is therefore respectfully submitted that any argument under Section 57j of the Bankruptcy Act is wholly beside the point, because interest is not a penalty, and the question of its payment or non-payment cannot be considered as coming within the purview of that section.

## POINT IV.

**From the point of view of orderly bankruptcy administration, and of fairness to other creditors, the practice of paying interest on tax claims up to the date of payment should be discontinued.**

The Court below gave as another reason for stopping interest on all debts as of the date of bankruptcy, that it is a matter of administrative convenience, and fundamental justice and equity, that interest should stop on the date when the petition was filed (Record, p. 33).

The protest because of this inequity was foreshadowed in *In re Dorsey* (1941), 46 A. B. R. (N. S.) 146. The practice was challenged by Referee Frebolin in *In re D. O. Summers*, 45 A. B. R. (N. S.) 123, and severely condemned by Judge Bright in the case of *In re Union Fabrics* (D. C. S. D. N. Y.), 73 Fed. Supp. 685. This last mentioned case is now before this Court on the petition of New York State against Carter, Trustee (Nos. 200 and 201), and will probably be argued together with this case.

To all those who practice in bankruptcy and who represent creditors in the administration of bankrupt estates, it is repugnant to the sense of fairness that such a practice, as is urged by the petitioner in this case, should be continued. The reason for that feeling of unfairness can be recognized when you consider just what happens to an estate in the process of bankruptcy administration, when the practice of paying interest on taxes up to the date of payment is enforced.

The interest is paid out of the fund in the hands of the Trustee available to all creditors. If the fund is large enough to pay administration expenses, priority claims, and unsecured creditors, then the payment of interest reduces the amount payable to unsecured creditors. It is they who are the losers. But these unsecured creditors have done nothing to bring that loss upon themselves. If interest is to be paid on a tax debt because of delay in payment, that delay is not caused by them. Not in a single instance is delay in payment of taxes caused by the unsecured creditors. Sometimes delay is caused by an empty bank account—there is no money in the estate to start with. If money is brought into the estate, that result is brought about by a diligent trustee, assisted by an equally diligent and able attorney, and very often with money advanced by the creditors for investigation. Sometimes delay is caused by legal controversies arising in the course of administration, which make appeals necessary. This makes it impractical to pay taxes, or interest, because the costs of administration come ahead of taxes. Sometimes (as in this case) the delay is caused by the governmental agency itself in not filing a proper tax in the first place, making objections necessary. These are followed by hearings, petitions to review, appeals to the Court of Appeals, sometimes followed by appeal to this Court.

Who gains by these delays? To whom do these delays mean a loss? The questions answer themselves. If ever there was a "rule" requiring the payment of interest up to the date of payment of the tax, that rule is not only "obsolete", to borrow a characterization from the Report of the Senate Committee (footnote on p. 14 of Petitioner's brief) but it should never

have been a "rule" in the first place. Now that the question has come squarely before this Court for decision, we respectfully urge that the answer should be the common-sense one, the one that squares with the broad principles underlying bankruptcy administration, viz. all debts cease bearing interest—compensation for delay in payment of principal—as of the day that the bankruptcy petition is filed.

## Conclusion.

We have not undertaken to discuss all of the various cases cited by the petitioner in its brief. We have discussed a few of them, but an examination of everyone, from the case of *In re Kallak* down, clearly indicates the erroneous assumption which led to the practice of paying interest up to the date of payment, to-wit, that interest is a penalty and comes under Section 57j of the Bankruptcy Act. We hope that we have convinced the Court by this argument that Section 57j does not apply. Indeed, that same error has crept into the argument of the petitioner; for, on page 6 of its brief, at the very outset of its argument, its counsel states that prior to the passage of the Chandler Act in 1938, "the rule was well established that by virtue of the provisions of Section 57j tax claims in bankruptcy bore interest to the date of payment". They then cite cases to support this erroneous premise from which their argument stems.

But we respectfully submit that counsel is wholly in error. Section 57j does not apply at all, because interest is not a penalty, and therefore, the cases they cite are wholly inappropriate to support the argument on the problem now before the Court.

From a careful consideration of all of the factors that enter into a proper discussion of the problem now before the Court, it seems to us that the decision of the Circuit Court of Appeals for the Second Circuit, in reversing the order of the District Court and declaring, with decisiveness, at long last, that taxes, like all other debts, do not bear interest beyond the date of bankruptcy, should be affirmed.

Respectfully submitted,

DAVID HAAR,
*Attorney for Respondent.*